JURISDICTION.

The taxpayer concedes the jurisdiction invoked by the Commissioner.

QUESTIONS PRESENTED.

1. Whether a dividend by a corporation, paid in its own preferred stock to holders of common stock, produces alteration of the pre-existing proportionate interests of the stockholders of the corporation, so as to result in such stock dividend being income of the recipient under the Sixteenth Amendment to the Constitution.

2. Assuming that such a dividend does constitute income under the Sixteenth Amendment, was such income taxable to the recipient under Section 115 of the Revenue Act of 1928?

3. Assuming that such a dividend does not constitute taxable income of the recipient, what is the correct cost basis of the dividend stock, when the recipient later sells it?

4. In the event that it should be held that the stock dividend in question was not taxable income of the recipient at the date of its receipt and that the cost basis of the dividend stock is not zero, the further question is presented whether the case should be remanded to the Board of Tax Appeals for further consideration and discussion with respect to the application of Section 115(g) of the Revenue Act of 1928 (dealing with the redemption of stock under such circumstances that it must be treated as equivalent to the distribution of a taxable dividend).

STATUTES AND REGULATIONS INVOLVED.

These will be found in the appendix, *infra*, pp. 15-17.

STATEMENT.

The petition for writ of certiorari contains a statement of facts which, in the main, is sufficiently accurate for the purposes of this argument. The taxpayer's additions and amendments to the statement of facts are as follows:

1. The petition herein states that the original report of a division of the Board (in favor of the taxpayer, and holding that there was no deficiency), dated June 29, 1933, was afterwards reviewed by the entire Board, and it is argued that the report of the division was therefore never any part of the record in the case. This is error. The statute invoked (Section 601 of the Revenue Act of 1928, amending Section 906(b) of the Revenue Act of 1924, *infra,* pp. 16-17) provides that the report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board. But in this case the original report of the division, finding that there was no deficiency, became a part of the record because the chairman of the Board did not direct that the report should be reviewed by the Board. On the contrary, the Commissioner's motion for review by the Board was denied by the chairman of the Board on July 24, 1933 (R. 33).

2. Most of the facts were stipulated. The entire stipulation is found in the above mentioned memorandum opinion of June 29, 1933 (R. 19 to 25). All other necessary facts were proved without dispute. The distribution of the stock dividend, of which the taxpayer received a part on July 1, 1929, was substantially as set forth in the Commissioner's pending petition; but it should be added that the preferred stock that was distributed in this dividend was (a) non-voting under any circumstances, (b) limited to $100 per share in case of liquidation, and (c) limited to a

dividend of seven per cent per annum out of profits. The common stock held by the taxpayer, on which this dividend was paid, had full voting power, and unlimited participation in assets and earnings after satisfying the calls of the preferred stock.

3. The statement of facts in the petition refers to the theory that the value of the dividend shares, if the same did not constitute taxable income when received, was zero, so that on subsequent sale the price received constituted taxable income. Petitioner's statement says that the Circuit Court of Appeals rejected this theory, but the statement does not disclose the fact that the theory of a basis-of-zero was not mentioned in the Commissioner's notice of deficiency given to the taxpayer, nor in the pleadings filed by the parties with the Board of Tax Appeals, nor in the findings and decision of the Board, but was first presented as an alternative argument in the brief of the Commissioner filed with the Circuit Court of Appeals.

Argument.

1. The court below assumed that a stock dividend, paid in preferred shares to holders of common shares, produces an alteration of the pre-existing proportionate interests of the stockholders, so as to result in income under the Sixteenth Amendment to the Constitution. The taxpayer does not admit that income under the Constitution arises in this way, and points out that there is a difference between a dividend in preferred shares on common and a dividend in common shares on preferred. The former does not change voting power nor disturb any stockholders' equity, while the latter does both. However, the point will not be argued here for the reason that this taxpayer's stock dividend was not subject to income tax, whether it constituted income under the Constitution or not.

2. Assuming that such a dividend does constitute income under the Sixteenth Amendment, was such income taxable to the recipient under Section 115 of the Revenue Act of 1928? The Revenue Act last mentioned was in force at the time when this taxpayer received his stock dividend on July 1, 1929, and Section 115(f) provided that "a stock dividend shall not be subject to tax."

The Circuit Court of Appeals for the Seventh Circuit in the present case, and the Circuit Court of Appeals for the Second Circuit in the case of *Pfeiffer* v. *Commissioner*, 88 Fed. (2d) 3, both held that Section 115(f) meant what it said, and that a stock dividend was exempt whether paid in the same class of stock previously held by the stockholder or in a different class. The opinion in the Pfeiffer case states that it is very clear from the opinion of this court in the Koshland case (*Koshland* v. *Helvering*, 298 U. S. 441) that Congress had left untaxed certain types of stock dividends which under the Constitution might have been lawfully taxed as income; also that the Koshland case indicates clear recognition that the exemption contained in the Revenue Act, Section 115(f), was broader than required by the decision of *Eisner* v. *Macomber*, 252 U. S. 189, and that such exemption must be considered coextensive with that contained in the Regulations.

The Regulations of the Treasury Department in effect at the time of the stock dividend in the Pfeiffer case and also this present case, provided that all dividends paid to stockholders of a corporation in stock of the same corporation should be exempt from income tax. (Art. 628, Regulations 74, *infra*, p. 17.)

Section 115(f) of the Revenue Act of 1928 is clear and unambiguous. It says "a stock dividend shall not be subject to tax". There is no room here for construction, or for consideration of legislative histories or reports of con-

gressional committees. It has been repeatedly so held by this court.

Osaka Shosen Kaisha Line v. *United States,* 81 L. Ed. (Adv. Ops.) 338, 339.

Kuehner v. *Irving Trust Company,* 81 L. Ed. (Adv. Ops.) 248, 250.

3. Assuming that a stock dividend of the kind involved here does not constitute taxable income of the recipient, what is the correct cost basis of the dividend stock, when the recipient later sells it? The Commissioner argues on this application that the cost basis must be zero, and that when the taxpayer later sold the stock for $100 per share he realized a capital gain of that amount. This was an idea brought into the case long after it had been tried and disposed of by the Board of Tax Appeals, as indicated above in paragraph 3 of our statement of facts. The three theories of tax liability asserted by the Commissioner at different times during the course of this proceeding were:

(a) That the distribution of the stock dividend and its later repurchase by the company made the transaction essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115(g) of the Revenue Act of 1928. This was the basis of liability disclosed by the Commissioner's deficiency letter and by the pleadings before the Board of Tax Appeals, and was disposed of by the first decision of the Board, holding in favor of the taxpayer on that issue (R. 18-28).

(b) That the stock dividend was taxable when received as if it had been cash, in spite of Section 115(f) of the Revenue Act of 1928. This theory was presented at the second argument before the Board and sustained by the Board, but the Board's decision was reversed by the Circuit Court of Appeals (R. 75-78).

(c) That the dividend when received had a basis for income tax purposes of zero, so that when later sold it gave the taxpayer a capital gain of $100 per

share. This basis of liability was never presented at any time to the Board of Tax Appeals. It was first presented as an alternative argument in the brief of the Commissioner filed with the court below.

This third theory is now brought forward as an additional ground for granting certiorari in this case. A sufficient answer is that it involves an issue raised for the first time before the Circuit Court of Appeals and one which should therefore be disregarded altogether.

General Utilities and Operating Company v. *Helvering*, 296 U. S. 200, 206.

Helvering v. *Salvage*, 297 U. S. 106, 109.

In the General Utilities case, this court said:

> "The second ground of objection, although sustained by the Court, was not presented to, or ruled upon by, the Board. The petition for review relied wholly upon the first point, and in the circumstances we think the Court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

The "basis-of-zero" theory is not entitled to be considered, because it was not properly raised.

But if nevertheless the "basis-of-zero" theory be considered here, it will be found to have no merit. The Board of Tax Appeals found that the fair market value of the dividend stock, when received by the taxpayer on July 1, 1929, was $100 per share. That finding has not at any time been disputed by either the Commissioner or the taxpayer. The court below took $100 per share as fair market value at date of distribution. At this point in our argument it will be assumed that the particular stock dividend in question was income within the constitutional definition, but was exempt from tax under Section 115(f) of the Revenue Act of 1928. The taxpayer, therefore, had an acquisition

of property on July 1, 1929, to wit: stock valued at $100 per share; and when the taxpayer later sold this property for $100 per share, there was no capital gain and no taxable income. That was the decision of the court below in this case, and it was clearly correct.

If, for income tax purposes at date of acquisition, the dividend stock had a value of $100 per share, then the same stock a few months later had precisely the same value per share as a basis for computing capital gain or loss on sale. The stock could not be valued at $100 per share for income tax purposes on July 1, 1929, and valued at something less than that, or at nothing at all, when later sold. The fact that the Government did not collect any income tax on the dividend income of the taxpayer (whether because the law exempted the transaction from tax or because the taxpayer failed to report the income) does not change the rule. The value of the shares for income tax purposes when received by the taxpayer continues to be the value of the shares, as a basis for computing capital gain on later sale, as settled by the decisions of the Circuit Court of Appeals for the Second Circuit and of this court in the Salvage case.

Salvage v. *Commissioner*, 76 Fed. (2d) 112 (Mar. 18, 1935). Affirmed: *Helvering* v. *Salvage*, 297 U. S. 106 (Jan. 13, 1936).

In the Salvage case, the Circuit Court of Appeals found that the taxpayer received in 1922 certain shares of stock having a fair market value at that date of $230,622, and that under the circumstances of the case that amount was taxable as income of the taxpayer in that year; that by mistake and oversight the taxpayer did not report that income and the same went untaxed; and that when the taxpayer sold the same stock in 1929, the basis of the stock for determination of capital gain was fair market value at date of acquisition, or $230,622. That decision was affirmed by this court.

In this connection it may properly be asserted that in the absence of statutes providing otherwise, the income tax basis of property acquired otherwise than by purchase is the fair value of such property on date of acquisition. Note that the Revenue Act of 1918 contained no provision determining the basis of valuation of gift property, when later sold so as to realize gain or loss; but the Treasury Department itself (Treasury Regulations 45, Article 1562, *infra*, p. 17) fixed such basis as fair market value at date of acquisition. That basis was approved by the Treasury Department and the courts until a later Revenue Act specifically provided another basis. In the instant case there is in the Revenue Act no specific provision governing the cost basis of stock acquired by a tax-free stock dividend, so that the situation is precisely analogous with that which prevailed as to property acquired by gift prior to the Revenue Act of 1921.

The Commissioner has not cited any law, rule or regulation which requires or justifies cutting the basis of these shares (for income tax purposes when the shares were later sold) down to anything below the fair market value when acquired; and it simply cannot be done in the face of the decisions in the Salvage case.

If, however, it be assumed that the stock dividend in the present case was not income within the rule of the Koshland case, because of its having been paid in preferred stock to holders of common, then the apportionment of the cost between the old and new stock was properly made by the taxpayer under the Treasury Regulations in force at the time, and the taxpayer's profit on later sale of the preferred shares was properly computed, and the tax paid thereon, leaving no deficiency.

4. In this application the Commissioner asks that if (a) the stock dividend was not taxable income of the recipient

at date of receipt and (b) the cost basis of the dividend stock is not zero, the case should be remanded to the Board of Tax Appeals for further consideration and discussion with respect to the first theory of the Commissioner, viz: that the taxpayer's sale of the dividend shares resulted in taxable income under the provisions of Section 115 (g) of the Revenue Act of 1928 (dealing with the redemption of stock under such circumstances that it must be treated as equivalent to the distribution of a taxable dividend). (*Infra*, p. 16.)

This was the question presented by the Commissioner's deficiency letter, and was the question placed in issue by the pleadings before the Board of Tax Appeals, and was decided in favor of the taxpayer by a division of the Board (R. 18-28). As shown above, the Commissioner promptly filed his motion for a review of that decision by the whole board, and that motion was denied by the chairman on July 24, 1933 (R. 33). Thereupon the decision of the division, embodied in its memorandum opinion, became a part of the record, and became the report of the Board thirty days after the date of the report of the division. (Section 601 of the Revenue Act of 1928, amending Section 906 (b) of the Revenue Act of 1924, *infra*, pp. 16-17.) The later proceedings before the Board of Tax Appeals and before the Circuit Court of Appeals did not disturb the original opinion nor the grounds upon which it was based.

In its second opinion the Board clearly recognized that on the issue tried out before the Board, being the issue as to which the facts were stipulated, the taxpayer had been successful and was entitled to a finding of no deficiency; but the Board then went on to say (R. 40):

> "He (the commissioner) determined that preferred shares issued as a dividend on the common shares of the Hamilton Manufacturing Company on July 1, 1929, were redeemed by the company in such a manner as to make the distribution essentially equivalent

to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928. The petitioners assigned error in such determination. The Board in its memorandum opinion heretofore entered considered the proceedings only upon the basis of such assigned error and determined *upon the facts* (emphasis supplied) that the preferred stock was not redeemed in 1929 in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend. The parties did not specifically raise, nor did the Board consider, the question of whether the dividend was tax-free or taxable to petitioners when the shares were issued on July 1, 1929. • • • (R. 41) If it be determined that the dividend was not a tax-free stock dividend when made on July 1, 1929, and therefore properly includable in income, that conclusion would be decisive here without passing upon the question of whether there was a redemption within the meaning of Section 115 (g) of the 1928 Act. There follow only those facts necessary to a determination of the one question now under consideration."

The second opinion of the Board says plainly that the Board had previously considered the proceedings upon the issue first raised, and had determined *upon the facts* that the preferred stock was not redeemed in 1929 in such manner as to bring the transaction within the provisions of Section 115 (g) of the Revenue Act of 1928; and the second opinion then goes on to a new decision which does not in any manner affect the finding and conclusion on the facts that had previously been made a matter of record. The second opinion clearly recognized the first decision in the taxpayer's favor and just as clearly left it standing without change.

Finally, the taxpayer points out that the finding in his favor on the first issue presented was on the facts and circumstances involved in this particular case, and does not

involve any question of public importance, and therefore furnishes no reason for granting certiorari.

Conclusion.

The application for a writ of certiorari in this case should be denied because:

1. There is here no conflict between decisions of circuit courts of appeals. On the contrary, two circuit courts of appeals have decided the main point in the same way.

2. The court below has not decided any important question of general law in a way probably in conflict with the weight of authority.

3. The court below has not decided any important question of Federal law which has not been (but should be) settled by this court. The decision that a stock dividend is not subject to income tax, under the provisions of the Revenue Act of 1928, is so obviously right that further consideration by this court is uncalled for. The taxpayer has urged that the question of a zero basis for the dividend shares, when later sold, should not be considered at all because not raised before the Board of Tax Appeals, but if it is to be considered, then the decision of the court below was right and no review is called for.

4. The claim of the Commissioner that a reason for granting certiorari is the large amount involved in similar pending cases is invalid. There is nothing in the record to support the Commissioner's assertion, and the taxpayer is without knowledge of the amounts involved in these other cases, or of the extent of the similarity; but it is urged that amounts involved in other similar cases do not warrant further review of a decision which, in this taxpayer's case, is so clearly correct.

5. The decision of the court below is not in conflict with applicable decisions of this court, nor has it departed from the usual course of judicial proceedings so as to call for an exercise of this court's power of supervision.

Respectfully submitted,

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Dated May 1, 1937.

APPENDIX.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 115. Distributions by Corporations.

(a) Definition of dividend.—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) Source of distributions.—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning

of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * * *

(f) Stock dividends.—A stock dividend shall not be subject to tax.

(g) Redemption of stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) Definition of partial liquidation.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Sec. 601. Board of Tax Appeals—Procedure.

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"Sec. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of

business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

"(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board.

* * * * * *

Treasury Regulations 74, relating to the Revenue Act of 1928:

Art. 628. Stock dividends.—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

Treasury Regulations 45, relating to the Act of 1918:

Art. 1562. In the case of property acquired by gift, bequest, devise or descent, the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition, or as of March 1, 1913, if acquired prior thereto. * * *"